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# FORM 10-Q

SEC
MAY 20 1992

## SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED APRIL 5, 1992

OR

__ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE TRANSITION PERIOD FROM_____TO_____

**Commission File Number 0-14980**

# NELLCOR INCORPORATED

(Exact name of registrant as specified in its charter)

| **Delaware** | **94-2789249** |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification No.) |

PROCESSED BY
MAY 21 1992

**25495 Whitesell Street**
**Hayward, California 94545**
(Address of principal executive offices)
(Zip Code)

Microfilmed by
Q-Data Corp. - St. Petersburg, FL

**Telephone: (510) 887-5858**
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes _X_ No ___

Number of shares of Common Stock, $.001 par value, outstanding as of April 5, 1992 was 16,035,226.

# PART I. FINANCIAL INFORMATION

**Item 1.** *Financial Statements*

*NELLCOR INCORPORATED CONSOLIDATED BALANCE SHEET*
*(In thousands)*

| ASSETS | April 5, 1992 (Unaudited) | July 7, 1991 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 16,348 | $ 15,623 |
| Marketable securities | 59,388 | 52,710 |
| Accounts receivable, net of allowance for doubtful accounts of $1,067 ($914 in July 1991) | 29,095 | 22,968 |
| Inventories (Note) | 18,902 | 20,058 |
| Deferred income taxes and other current assets | 6,584 | 5,395 |
| Total current assets | 130,317 | 116,754 |
| Property and equipment, at cost | 52,731 | 43,606 |
| Accumulated depreciation and amortization | (27,943) | (23,618) |
| Net property and equipment | 24,788 | 19,988 |
| Other assets and goodwill, net of accumulated amortization | 21,823 | 6,094 |
| | $176,928 | $142,836 |
| **LIABILITIES & STOCKHOLDERS' EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 10,627 | $ 8,090 |
| Accrued liabilities: | | |
| Payroll and payroll related | 7,172 | 5,432 |
| Warranty | 2,251 | 1,530 |
| Other | 7,521 | 2,058 |
| Income taxes payable | 3,726 | 3,443 |
| Total current liabilities | 31,297 | 20,553 |
| Deferred income taxes | 703 | 899 |
| Stockholders' equity: | | |
| Common stock, par value | 16 | 16 |
| Additional paid-in capital | 70,767 | 62,261 |
| Retained earnings | 74,747 | 60,359 |
| Accumulated translation adjustment | 146 | 122 |
| Unearned compensation and notes receivable from stockholders | (748) | (1,374) |
| Total stockholders' equity | 144,928 | 121,384 |
| | $176,928 | $142,836 |

*NELLCOR INCORPORATED CONSOLIDATED STATEMENT OF INCOME*
*(In thousands, except per share amounts, unaudited)*

| | For the Three Months Ended | | For the Nine Months Ended | |
|---|---|---|---|---|
| | April 5, 1992 | April 7, 1991 | April 5, 1992 | April 7, 1991 |
| Net revenue | $52,920 | $41,628 | $141,988 | $116,437 |
| Cost of goods sold | 20,413 | 18,661 | 58,392 | 53,130 |
| Gross profit | 32,507 | 22,967 | 83,596 | 63,307 |
| Operating expenses: | | | | |
| Research, development and engineering | 6,004 | 3,486 | 16,228 | 10,560 |
| Selling, general and administrative | 17,515 | 12,645 | 46,880 | 37,067 |
| Restructuring charge | — | — | — | 1,500 |
| Income from operations | 8,988 | 6,836 | 20,488 | 14,180 |
| Interest and other, net | 716 | 881 | 2,717 | 2,634 |
| Income before income taxes | 9,704 | 7,717 | 23,205 | 16,814 |
| Provision for income taxes | 3,687 | 2,856 | 8,817 | 6,222 |
| Net income | $ 6,017 | $ 4,861 | $ 14,388 | $ 10,592 |
| Net income per common and common equivalent share | $ 0.36 | $ 0.31 | $ 0.89 | $ 0.69 |
| Common and common equivalent shares used in the calculation of income per share | 16,613 | 15,565 | 16,240 | 15,387 |

*See accompanying note.*

## *NELLCOR INCORPORATED CONSOLIDATED STATEMENT OF CASH FLOWS*

*(In thousands, unaudited)*

| | For the Nine Months Ended | |
|---|---|---|
| | April 5, 1992 | April 7, 1991 |
| **Cash flows from operating activities:** | | |
| Net income | $ 14,388 | $ 10,592 |
| Adjustments to reconcile net income to cash provided by operating activities: | | |
| Depreciation and amortization | 7,140 | 4,389 |
| Unearned compensation | 549 | 549 |
| Deferred income taxes | (196) | 10 |
| Increases (decreases) in cash flows, net of effects from purchase of companies, as a result of changes in: | | |
| Accounts receivable | (4,907) | 332 |
| Inventories | 1,948 | (368) |
| Other current assets | (1,038) | (161) |
| Other assets | (902) | 79 |
| Accounts payable | 2,500 | (2,375) |
| Accrued liabilities | 6,097 | (82) |
| Income taxes payable | 303 | 2,251 |
| **Cash provided by operating activities** | 25,882 | 15,216 |
| **Cash flows from investing activities:** | | |
| Capital expenditures | (10,139) | (3,397) |
| Cash used to purchase marketable securities | (76,948) | (57,253) |
| Proceeds from sales and maturities of marketable securities | 70,270 | 46,826 |
| Payments for purchases of companies, net of cash acquired | (17,122) | — |
| Acquisition of marketing rights | — | (1,000) |
| **Cash used in investing activities** | (33,939) | (14,824) |
| **Cash flows from financing activities:** | | |
| Proceeds from the sale of common stock and related tax benefits, net of repurchases, and stockholder notes receivable | 8,583 | 2,984 |
| **Cash provided by financing activities** | 8,583 | 2,984 |
| **Effect of exchange rate changes on cash balances** | 199 | 84 |
| **Increase in cash and cash equivalents** | 725 | 3,460 |
| **Cash and cash equivalents at the beginning of the period** | 15,623 | 10,771 |
| **Cash and cash equivalents at the end of the period** | $ 16,348 | $ 14,231 |

*See accompanying note.*

*NELLCOR INCORPORATED NOTE TO CONSOLIDATED FINANCIAL STATEMENTS*
*(In thousands, unaudited)*

*General.* The consolidated financial statements reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position and results of operations as of the end of and for the periods indicated.

The accompanying interim consolidated financial statements should be read in conjunction with the financial statements and related notes included in the Company's 1991 Annual Report to Stockholders. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the Securities and Exchange Commission rules and regulations. The Company believes the information included in the report on Form 10-Q, when read in conjunction with the Consolidated Financial Statements and related Notes thereto included in the Company's 1991 Annual Report to Stockholders, is not misleading.

The results of operations for the three-month and nine-month periods ended April 5, 1992 are not necessarily indicative of operating results for the full fiscal year.

*Inventories.* Inventories are stated at the lower of cost (first-in, first-out) or market (net realizable value). Interim and year-end inventory balances were as follows (in thousands):

| | April 5, 1992 | July 7, 1991 (Audited) |
|---|---|---|
| Raw materials | $ 9,507 | $ 9,668 |
| Work-in-process | 3,779 | 4,184 |
| Finished goods | 5,616 | 6,206 |
| | $ 18,902 | $ 20,058 |

*Statement of Cash Flows.* The Company paid income taxes of approximately $6,820 and $3,696 in the nine months ended April 5, 1992 and April 7, 1991, respectively.

*Acquisitions.* In September 1991 the Company acquired the outstanding stock of EdenTec Corporation (EdenTec) for $8.9 million in cash. EdenTec manufactures infant and adult sleep apnea monitors and diagnostic systems. The consolidated Income Statement of the Company for the first nine months of fiscal 1992 includes the results of operations for EdenTec from the date of acquisition, September 12, 1991. The transaction was accounted for as a purchase and the excess of the purchase price over the fair value of the net assets of EdenTec was recorded as goodwill which is to be amortized on a straight line basis over seven years. In connection with the acquisition, certain former principal shareholders of EdenTec will receive $1.1 million under employment contracts, payable in installments and accrued ratably through fiscal 1994, contingent upon their continued employment and attainment of certain performance objectives.

Also in September 1991, the Company acquired substantially all the assets of Fenem, Inc., a producer of a disposable noninvasive CO2 detection device, for $8.8 million in cash. The transaction was accounted for as a purchase and the excess of the purchase price over the fair value of the assets of Fenem was recorded as goodwill which is to be amortized on a straight line basis over eight years.

If these acquisitions had been completed as of the beginning of the first quarter of fiscal 1991, the Company estimates that pro forma net revenue in the third quarter of fiscal 1992 would have been unchanged and net revenue in the third quarter of fiscal 1991 would have been approximately $43.0 million. Pro forma net revenue would have been approximately $143.1 million in the first nine months of fiscal 1992 and approximately $121.0 million in the first nine months of fiscal 1991. Net income would have been unchanged in the third quarter of fiscal 1992 and approximately $4.0 million, $0.26 per share, in the third quarter of fiscal 1991. Net income for the first nine months of fiscal 1992 would have been approximately $13.7 million, $0.85 per share, and net income for the first nine months of fiscal 1991 would have been approximately $7.8 million, $0.51 per share.

Supplemental cash flow disclosure related to the acquisition of EdenTec is as follows:

| | |
|---|---|
| Fair value of assets acquired | $ 9,779 |
| Acquired research, development and engineering expenses | 299 |
| Liabilities assumed | (1,152) |
| Cash paid to acquire EdenTec | $ 8,926 |

**Item 2.** *Management's Discussion and Analysis of Financial Condition and Results of Operations.*

**Results of Operations - Year-to-date period and third quarter ended April 5, 1992 compared with the year-to-date period and third quarter ended April 7, 1991.**

The Company's net revenue for the third quarter of fiscal 1992 increased to $52.9 million from $41.6 million in the third quarter of fiscal 1991 and increased to $142.0 million in the first nine months of fiscal 1992 from $116.4 million in the same period last year. The increase in net revenue in both the third quarter and the first nine months of fiscal 1992 over the same periods in fiscal 1991 principally reflects increased sales of patient-dedicated sensors, which have resulted from continued growth in the installed base of the Company's monitors and the products of the Company's licensees and OEM customers. Oximeter revenue increased in the third quarter and first nine months of fiscal 1992 compared to the same periods a year ago due principally to higher unit sales of OEM modules and sales of the N-180 oximeter, a product not commercially available in fiscal 1991, partially offset by lower unit sales of the N-200. Revenue from gas products decreased in both the third quarter and first nine months of fiscal 1992 from the comparable periods last year principally as a result of lower sales volumes of the N-1000 multi-function monitor and the N-2500 anesthesia safety monitor in both North America and Europe.

International revenue increased to $9.3 million in the third quarter of fiscal 1992 from $7.9 million in the prior year third quarter and increased to $23.9 million in the first nine months of fiscal 1992 from $22.3 million in the same period of fiscal 1991, due primarily to increased sales in Canada, the Pacific Rim and Europe. Sales by EdenTec Corporation into the home healthcare market and sales of *EASY CAP*™, the $CO_2$ detection product acquired from Fenem, Inc. also contributed to the increase in consolidated net revenue.

Gross profit as a percentage of net revenue increased to 61 percent in the third quarter of fiscal 1992 from 55 percent in the third quarter of fiscal 1991. The increase in gross margin was primarily due to the favorable impact of the continued shift in product mix to patient-dedicated sensors, product cost improvements, and improved manufacturing overhead absorption. These favorable margin impacts were partially offset by the amortization of expenses resulting from the acquisition of the assets of Fenem, Inc. For the first nine months of fiscal 1992 gross profit increased to 59 percent of net revenue from 54 percent in the same period a year ago principally reflecting the favorable impact of the continued shift in product mix to patient-dedicated sensors and product cost improvements partially offset by expenses resulting from the acquisition of the assets of Fenem, Inc.

Research, development and engineering expenses were 11 percent of net revenue in both the third quarter and the first nine months of fiscal 1992 compared to eight percent in the third quarter of fiscal 1991 and nine percent in the first nine months of fiscal 1991. Research, development and engineering expenses increased between the comparable periods due principally to increased spending on the development of network-based and fetal pulse oximetry products and expenses resulting from the acquisition of EdenTec Corporation.

Selling, general and administrative expenses as a percentage of net revenue were 33 percent in the third quarter and first nine months of fiscal 1992, 30 percent in the third quarter of fiscal 1991 and 32 percent in the first nine months of fiscal 1991. The increase in both the third quarter and first nine months of fiscal 1992 was due principally to operating and amortization expenses resulting from the acquisition of EdenTec Corporation, expenses associated with the organization of the company into divisions and investment in the Company's business computer systems.

Net income was $6.0 million for the third quarter and $14.4 million for the first nine months of fiscal 1992 compared to $4.9 million for the third quarter and $10.6 million for the first nine months of fiscal 1991. Net income for the third quarter of fiscal 1992 reflects amortization and other expenses related to the acquisitions of EdenTec Corporation and the assets of Fenem, Inc. of approximately $661,000, net of taxes. For the first nine months of fiscal 1992 these expenses were approximately $1.5 million, net of taxes. Net income for the first nine months of fiscal 1991 includes a restructuring charge which reduced net income by approximately $945,000, net of taxes, recorded in the second quarter of fiscal 1991.

**Liquidity and Capital Resources**

The Company met its liquidity and capital requirements from internally generated cash during the first nine months of fiscal 1992. At April 5, 1992, the Company had cash, cash equivalents and marketable securities amounting to approximately $75.7 million compared to $68.3 million at the end of fiscal 1991.

Operating activities provided positive cash flows during the first nine months of fiscal 1992. Depreciation and amortization expense was a significant non-cash operating expense during this period. The acquisitions of EdenTec Corporation and the assets of Fenem, Inc. for $17.1 million and capital expenditures were the principal uses of cash in investment activities since the fiscal 1991 year end. Proceeds from the exercise of stock options were the principal source of cash from financing activities during the first nine months of fiscal 1992.

# PART II. OTHER INFORMATION

**Item 6.** ***Exhibits and Reports on Form 8-K.***

a) Exhibits.

**11.1** Statement of computation of net income per share.

**19.1** Second Amendment to Lease Agreement between Registrant and Britannia Developments, Inc., filed as Exhibit 10.8 to Form 10-K for the year ended July 7, 1991.

b) Reports on Form 8-K.
No reports on Form 8-K were filed during the quarter ended April 5, 1992.

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be filed on its behalf by the undersigned thereunto duly authorized.

NELLCOR INCORPORATED

Dated 5/18/92

By _____
Michael P. Downey
Vice President and
Chief Financial Officer
(Principal Financial and Accounting Officer)

# EXHIBIT INDEX

| Exhibit No. | Description | Location in Form 10-Q |
|---|---|---|
| 11.1 | Statement of computation of net income per share | 12 |
| 19.1 | Second Amendment to Lease Agreement between Registrant and Britannia Developments, Inc., filed as Exhibit 10.8 to Form 10-K for the year ended July 7, 1991. | 13 |

**Exhibit 11.1**

*NELLCOR INCORPORATED STATEMENT OF COMPUTATION OF NET INCOME PER SHARE*
*(In thousands, except per share amounts, unaudited)*

| | For the Three Months Ended | | For the Nine Months Ended | |
|---|---|---|---|---|
| | April 5, 1992 | April 7, 1991 | April 5, 1992 | April 7, 1991 |
| Computation of common and common equivalent shares outstanding: | | | | |
| Common stock | 15,990 | 15,222 | 15,755 | 15,096 |
| Common stock equivalents | 623 | 343 | 485 | 291 |
| Common and common equivalent shares used in the calculation of income per share | 16,613 | 15,565 | 16,240 | 15,387 |
| Net income | $ 6,017 | $ 4,861 | $14,388 | $10,592 |
| Net income per common and common equivalent share | $ 0.36 | $ 0.31 | $ 0.89 | $ 0.69 |

SECOND AMENDMENT TO
BRITANNIA BUSINESS CENTER AT HACIENDA
BUILD-TO-SUIT LEASE
AND WORKLETTER AGREEMENT

THIS SECOND AMENDMENT is dated for reference purposes as of the 10th day of April, 1992 by and between Britannia Developments, Inc., a California corporation ("Lessor") and Nellcor Incorporated, a Delaware corporation ("Lessee"), amending the Build-To-Suit Lease dated April 18, 1991 between Lessor and Lessee, as amended (the "Lease"). Capitalized terms used herein and not otherwise defined shall have the meanings set forth in the Lease.

WHEREAS, Lessor and Lessee desire to amend the Lease to modify one existing condition and add an additional condition to the effectiveness of the Lease.

IT IS AGREED THAT the Lease is hereby amended as follows:

1. Section 47(g) is amended to read as follows: "Commencement by Lessor of the construction of improvements by October 31, 1992."

2. A Section 47(h) is hereby added to the Lease as follows: "Repayment in full by October 31, 1992 of that certain term note made by Britannia to The Prudential Insurance Company of America in the principal amount of $1,352,930.00 and dated substantially concurrently with this Amendment."

IN WITNESS WHEREOF, the undersigned have executed this Second Amendment to Lease as of the date first set forth above.

**Lessor**

BRITANNIA DEVELOPMENTS, INC.,
a California corporation

By: _____

Dated: April 10, 1992

**Lessee**

NELLCOR INCORPORATED,
a Delaware corporation

By: _____
Michael P. Downey
Vice President and
Chief Financial
Officer

By: _____
Ted H. Toch, VP & General Manag

April 10, 1992